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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 237

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., *Petitioner,*

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA, and THE EQUITY ANNUITY LIFE INSURANCE COMPANY, *Respondents.*

No. 290

SECURITIES AND EXCHANGE COMMISSION, *Petitioner,*

v.

VARIABLE ANNUITY LIFE INSURANCE COMPANY OF AMERICA and THE EQUITY ANNUITY LIFE INSURANCE COMPANY, *Respondents.*

On Petitions for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR RESPONDENT THE EQUITY ANNUITY LIFE INSURANCE COMPANY IN OPPOSITION

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OPINIONS BELOW

The findings of fact and conclusions of law of the United States District Court for the District of Columbia are printed at pages 94-112 of the record. The opinion of the District Court is reported at 155 F. Supp. 521. The opinion of the Court of Appeals is not

yet reported but is printed as Appendix A to the Petition of the Solicitor General.

QUESTION PRESENTED

Did the Court of Appeals properly interpret the statutes herein involved and the legislative intent underlying them in holding that, there is "an unmistakable determination on the part of Congress to leave the insurance business in the control of the States until Congress should in plain terms exert its power over some or all aspects of it . . ." and "The definitions in the Securities Act and the Investment Company Act indicate that if the insurance commissioner of a state subjects the business to his supervision, it is the business of insurance".

STATUTES INVOLVED

The statutes involved are set forth in Appendix B to the petition of the Solicitor General with the exception of the District of Columbia Life Insurance Act of 1934, Title 35, Chapters 3-8 of the District of Columbia Code (1951 Ed.). It is not practicable to set out such Act in this Brief.

STATEMENT OF THE CASE

The undisputed facts of record are that respondents were organized and operate as life insurance companies under the provisions of the District of Columbia Life Insurance Act of 1934 and that they are subject to the supervision of the Superintendent of Insurance of the District of Columbia and the insurance commissioners of other states in which they are licensed to do business. The only business which they are authorized to conduct "shall be restricted to the business of insurance appertaining to persons". Title 35, § 501(d), D. C. Code. It is the regulation of the

"business of insurance" which the McCarran-Ferguson Insurance Regulation Act leaves exclusively to the several states.

The variable annuities issued by respondents have been described thusly

> *A variable annuity contract, . . ., is an annuity contract* under which payments to the annuitant are calculated pursuant to actuarial principles of life contingencies predicated upon an assumed annual investment increment rate in such manner that the annuity payments will remain uniform in dollar amount if actual investment experience conforms to the assumed investment increment rate. The contracts provide that the amount of the payments to the annuitant will vary only to the extent that the actual investment experience varies from the assumed investment increment rate. The amount of such payments to the annuitant prescribed by the contract cannot be decreased by adverse mortality experience or by any increase in the company's expenses in excess of the expense deduction provided for in the policy, but may be decreased by investment losses. (F.F. 30, R. 100-101) (Emphasis supplied).

Participating annuities written by the life insurance industry generally, wherein payments vary in accordance with the Company's investment experience, are described by the District Court

> Under participating annuity policy contracts, the amount of the payments to the annuitant may vary due to the declaration by the insurance company of dividends to the annuitant arising from experience more favorable than anticipated with respect to mortality, investment earnings and expenses. Plaintiff SEC does not contend, neither has it shown, that it has ever instituted any legal or administrative action charging that annuity policies payable in fixed-dollar amounts issued on a participating basis are "securities" under the

Securities Act of 1933, or that the insurance companies issuing such policies are "investment companies" under the Investment Company Act of 1940.
(F.F. 28, R. 100).

No finding of fact by the District Court has ever been challenged by petitioners.

With regard to the Question Presented in this Brief, the District Court held

> In view of the fact that the defendants have been chartered as insurance companies by the District of Columbia and their questioned contracts have been approved by the Insurance Superintendent of the District, and by the insurance departments of certain states, this Court is constrained to hold that the broad, explicit and impelling language of the McCarran Act makes them exempt from Federal regulation unless and until Congress provides otherwise.
>
> * * * *
>
> The Congress, however, has barred all Federal agencies from access to that field, except those specifically named, and SEC has not been named. The broad and exclusive effect of the McCarran Act has been sustained by the Supreme Court and by the Courts of Appeal.
>
> * * * *
>
> At trial, parties, counsel and Court seemed to recognize that there were issues involved in this controversy which would have to be determined by Congress, no matter what decision in this case was made by this or any other court—that Congress might have to provide for new rules and regulations covering variable annuities.
>
> * * * *
>
> It is the judgment of this Court that Congress only can make such contracts and companies amenable to the regulations of SEC.
> 155 F. Supp. 521, 527, 528.

With regard to the Question Presented in this Brief the Court of Appeals held:

> The statutes which we have quoted above show an unmistakable determination on the part of Congress to leave the insurance business in the control of the States until Congress should in plain terms exert its power over some or all aspects of it. The appellants say that, by definition, the business of the appellees is not insurance. We find no such definition. The definitions in the Securities Act and the Investment Company Act indicate that if the insurance commissioner of a state subjects the business to his supervision, it is the business of insurance. . . . The new business will need the expert and watchful supervision of these experts in insurance. We think the statutes lodge the responsibility with them.

From the reasoning of both courts below it is clear that a life insurance company, organized and regulated under state laws, and its insurance and annuity policies are exempt from the Securities Act and the Investment Company Act and that Congress has determined that the sole regulation of the company shall rest with the several states.

REASONS FOR DENYING THE WRIT

The petition of the Solicitor General urges three reasons for granting the writ. These will be considered in order.

I

The first reason advanced by the Solicitor General is in essence an assertion that the decision below deprives respondents' policyholders of the protection afforded by the disclosure requirements of the Securities Act.

Regulation of insurance companies and their policies commenced in the United States in 1851. Each state or territory today has a department of insurance which regulates not only domestic companies, but all foreign companies doing business therein. 322 U.S. 533, 584. The nature of the regulation of the business of insurance has been described by the District Court

> The business of insurance is regulated by District and State insurance departments, such regulations among others including (i) control of organization of the company—prescribing minimum capital and minimum surpluses; (ii) regulation of financial structure of the company by regulating valuation of assets, valuation of reserve liabilities and determining investment categories; (iii) regulation of policy forms; and (iv) business methods, that is, regulation and licensing of agents and control of advertising and literature. (F.F. 26, R. 99).

Despite this unchallenged finding the Solicitor General now raises an issue, not raised in the pleadings or at trial, as to the adequacy and efficiency of state insurance regulation in protecting the public through full disclosure of relevant information about a policy.

Disclosure is but one of a number of regulatory devices which insurance regulation utilizes. Insurance regulation does not depend solely upon disclosure but embraces all substantive aspects of the company, its management, its operations and all provisions of its policies. As contrasted with SEC Rule 425, requiring every prospectus to state on its cover that "these securities have not been approved or disapproved by the Securities and Exchange Commission nor has the Commission passed upon the accuracy or adequacy of this prospectus", no policy of insurance may be issued in the District of Columbia until approved for form

and substance by the Superintendent of Insurance. As the Fifth Circuit Court of Appeals has stated, "... the business of insurance has been more generally regulated than any other sphere of business activity not a public utility." *American Hospital & Life Insurance Co.* v. *FTC.*, 243 F. (2d) 719, 721, aff'd 357 U.S. 560.

In enacting the Securities Act of 1933 Congress recognized the need for disclosure concerning securities, the interstate sale of which were theretofore federally unsupervised. Congress was then familiar with the plenary regulation of insurance companies by the several states. In obvious recognition of the fact that insurance and annuities were not considered to be within the intendment of the Securities Act, the House Committee stated that their specific exemption from the Act was included so as to make unmistakable "... what is already implied in the Act, that insurance policies are not to be regarded as securities subject to the provisions of the Act." H. Rept. No. 85, 73rd Cong., p. 15.

The disclosure requirement of the Securities Act is appropriate to the securities field, but serves no useful purpose in the field of insurance where the company, its activities and its products are scrutinized and tested from their inception. The attempt to saddle securities statutes upon life insurance will occasion extensive clashes of regulatory policies and would "take a generation of litigation to determine." 322 U.S. 533, 590.

Regardless of what SEC and the National Association of Securities Dealers now assert to be their purpose in instituting or intervening in the litigation, it is undenied by petitioners that if the Investment Company Act were applicable to respondent, sections 18(f)

and 18(a)(1)(A) of the Investment Company Act would make illegal its insurance business conducted in conformity with District of Columbia law.

II

The second contention advanced by the Solicitor General is that Congress has created a procedure whereby, after a state legislature (or as here, Congress) and an insurance commissioner have authorized a particular insurance policy, that policy and the company issuing it are not perforce exempt from the jurisdiction of the SEC, until the federal judiciary has determined whether such policy is to be considered insurance. (Pet., p. 14).

Such a procedure cannot be found in the language or legislative history of the Securities and Investment Company Acts. Nor can support for such a litigious proposition be found in the McCarran-Ferguson Insurance Regulation Act. The language of that Act precluding the assertion of jurisdiction over insurance companies by federal agencies is clear, and, was intended

> . . . broadly to give support to the existing and future state systems for regulating and taxing the business of insurance . . . by removing obstructions which might be thought to flow from its own power, whether dormant or exercised, *except as otherwise expressly provided in the Act itself or in future legislation. Prudential Ins. Co.* v. *Benjamin,* 328 U.S. 408, 429-430. (Emphasis supplied).

The procedure advocated by the Solicitor General flies in the face of established state-federal relationships and would be an intrusion into the area of state regulation prohibited by the McCarran-Ferguson In-

surance Regulation Act. Such regulatory intrusion by SEC upon established state insurance regulation systems, as admitted by a former SEC Commissioner (R. 402), would make it "probable that in the regulation of the business of insurance by both the federal and state governments there will develop a confict of policies. The parties agree that in such event the federal regulation would control. If so, 'the continued regulation and taxation by the several states,' referred to in Section 1 of the Act as being in the public interest, would no longer exist." *National Casualty Co.* v. *FTC*, 245 F. (2d) 883, 887, aff'd 357 U.S. 560. Indeed, in Nos. 435 and 436, October Term, 1957, the Solicitor General stated that where specific state insurance laws sanction what federal law forbids (and no federal law even authorizes the organization of an insurance company) the mere enactment of the statute renders certain federal laws (presumably all statutes save the three enumerated in section 2(b) of the McCarran Act) inapplicable "for, in that event, there is an obvious collision between federal and state policy and Congress has decreed that state policy should be controlling." Brief, p. 25.

As opposed to the extraordinary procedure for determining the meaning of "insurance" which the Solicitor General proposes, the practicality and wisdom of the existing procedure established by Congress is apparent. Under the Securities Act the test of what constitutes any insurance policy is that it be "issued by a corporation subject to the supervision of the insurance commissioner . . .". Under the Investment Company Act the definition of an insurance company, exempt from the Act, is "a company which is organized as an insurance company, whose primary and predominant business activity is the writing of

insurance . . ., and which is subject to supervision by the insurance commissioner . . ."

There can be no question that respondent is organized as a life insurance company; there can be no question that it has been determined under the D. C. Life Insurance Act as well as by the courts below that respondent's variable annuity policies are insurance; there can be no question that respondent is supervised and regulated by several insurance commissioners; and there can be no question that not only respondent's primary business but respondent's sole business is the writing of insurance according to the law of the District of Columbia. It is submitted that the Court below was correct in holding that

> The definitions in the Securities Act and the Investment Company Act indicate that if the insurance commissioner of a state subjects the business to his supervision, it is the business of insurance.

As Congress has said:

> If the States are to be permitted to regulate, they should be permitted to regulate as they see fit. The Committee believe that in considering the nature of the business of insurance, its closeness to policyholders in the several States, the established systems of regulation and control by the States, and the experience and attitude of State insurance commissioners, regulation by the States should not be circumscribed by the establishment of any control over their power of regulation or the exercise by them of that power. H. Rept. No. 873, 78th Cong.

The proposed procedure of determining whether a particular policy issued by an insurance company is "insurance" by submitting the question to the federal judiciary would involve far more than a determination

regarding the particular policies herein. It is the Commission's position (Pet., p. 8)—where an insurance company invests in legally permissible common stocks and its annuity benefit varies with the company's investment experience—then Congress intended SEC to regulate the insurance company. It should be noted that nowhere in the securities acts can be found any delineation between the types of investments or the variations of policies issued by insurance companies.

With regard to the questioned extent of investment in common stocks, the Commission's quarrel is with Congress for enacting § 535 of Title 35 of the District of Columbia Code wherein the legally permissible investments for all domestic insurance companies are set forth in detail. (F.F. 39, R. 106). The bogeyman of possible speculative investments under District of Columbia law, set out on pages 10 and 11 of the Solicitor General's Petition, does not exist and cannot materialize because of the investment limitations of the law. It reflects no credit upon petitioner to advance such an unfounded assertion.

The Commission's position that the distribution of investment experience between Company and policyholder determines its jurisdiction, is likewise without foundation. No such intention of Congress can be gleaned from the reading of the statutes herein involved. The position the Commission is here contending for would presumably require it to assert its jurisdiction over: (1) all mutual life insurance companies (constituting 63% of all life insurance in force)[1] since their policyholders necessarily bear all risks including investment risks (R. 298); in fact, the then senior

[1] Life Insurance Fact Book, 1958, p. 98. Institute of Life Insurance.

governor of the New York Stock Exchange testified that in his opinion every policy issued by a mutual life insurance company is, in part, a security. (R. 391); (2) the variable annuity issued by College Retirement Equities Fund to teachers throughout the United States (R. 480-485); (3) participating annuities issued by most major insurance companies (R. 100); the immediate participation guaranteed (IPG) contracts, where the investment experience of the company is entirely reflected in the accumulated value of the contract, sold by all of the major life insurance companies including Metropolitan, Equitable, John Hancock, Prudential and Connecticut General. (R. 539, 553-554, 561).

Most assuredly a generation of litigation would follow from the extraordinary construction of the law which the SEC espouses.

III

The third reason advanced by the Solicitor General consists of a professed concern as to whether the ruling below will allow mutual funds regulated under the Investment Company Act to "escape the jurisdiction of this Commission." (Pet., p. 18). This result, it is said, would be accomplished by adding an optional annuity provision to a periodic investment plan and thus, mirabile dictu, the mutual funds would escape the jurisdiction of the Commission.

Mutual funds cannot legally concern themselves with life contingencies and such contingencies have no bearing on the value of a shareholder's interest in the mutual fund. Conversely, from the moment respondent issues a policy it has necessarily predicted, through the use of a mortality table, how long the policyholder will live and must calculate the necessary reserve. This prediction and calculation is essential in deter-

mining the amount of future annuity payments to the policyholder. If a group of policyholders live beyond their predicted mortality their payments continue unabated, while respondent must make good its obligations from earnings or capital.

The record is clear that only a life insurance company can offer any contract based on life contingencies (R. 441) and petitioners have never before questioned this fact. It is a legal impossibility for mutual funds to issue an annuity since only a life insurance company can issue an annuity. It is likewise certain that mutual funds are without the purview of insurance statutes and cannot become insurance companies without abandoning their present business in toto.

It is difficult to believe that this phantasmagoria is urged as a reason for granting certiorari.

CONCLUSION

The concurrent findings of both courts below are amply supported by the record and do not warrant further review. The decision below is correct and no substantial issue calling for further review by this Court is presented. The petitions for a writ of certiorari should be denied.

Respectfully submitted,

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